No. 2594.

In the

United States Circuit Court of Appeals

For the Ninth Circuit.

F. G. NOYES, as Receiver of WASHINGTON-ALASKA BANK, a Corporation, - - - - - - - *Appellant,*

VERSUS

R. C. WOOD, - - - - - - - - - - - - - *Appellee.*

UPON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE TERRITORY OF ALASKA, FOURTH DIVISION.

BRIEF *of* APPELLANT.

O. L. RIDER,
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INDEX.

Trial was had to the court and Findings of Fact and Conclusions of Law were made and entered (Rec., pp. 68 to 84). Upon its Findings of Fact, the court found as a Conclusion of Law (Rec., p. 84): "That the plaintiff take nothing against the defendant, R. C. Wood, on the cause of action stated in the complaint, and that said action be dismissed." Afterwards Decree (Rec., pp. 85-87) was duly entered in accordance with said Conclusion of Law "that plaintiff take nothing against the defendant, R. C. Wood, by reason of his complaint herein, and that said action be and the same is hereby dismissed at the cost of plaintiff." (Rec., pp. 87-88.)

Plaintiff by Bill of Exceptions, duly settled and allowed (Rec., pp. 88-89), saved exceptions to said Conclusion of Law and to said Decree based thereon, on the ground as to each "that the same is contrary to the facts found by the court and contrary to law."

The case is here on plaintiff's appeal to test the accuracy of said Conclusion of Law and Decree upon the facts found by the court. Since there is no question here as to the correctness of the facts found, the only question being the correct application of the law thereto, the pleadings are not set out in this brief. Said Findings of Fact and Conclusions of Law fully and conveniently present the issues involved, and they are as follows (Rec., pp. 69-84):

I.

" That the Washington-Alaska Bank, of which the plaintiff is receiver, was incorporated under the laws of the State of Nevada on the 21st day of January, 1908, with an authorized capital stock of $300,000.00 divided into 3,000 shares of the par value of $100.00 each; that said bank was incorporated under the name of the Fairbanks Banking Company; and that subsequently, by amendment to its Articles of Incorporation, said name was changed to Washington-Alaska Bank.

II.

" That said bank commenced business in the town of Fairbanks, Alaska, on the 16th day of March, 1908, with a subscribed capital of $206,000.00, part of which was paid for in cash, part in property, and the balance by the promissory notes of the subscribers.

III.

" That prior to the 21st day of January, 1908, subscriptions for said capital stock were circulated, and the following persons among others, subscribed for shares thereof, to-wit, E. T. Barnette, 440 shares; R. C. Wood, 220 shares; James W. Hill, 220 shares; the name of R. C. Wood being subscribed thereto by said E. T. Barnette.

IV.

" That prior to the incorporation of said bank, the said Barnette, Hill and Wood, as copartners, were conducting a banking business in said town of Fairbanks under the firm name and style of Fairbanks Banking Company, which said company in December, 1907, owing

to financial difficulties, was unable to meet its obligations and was compelled to suspend business and close its doors, and was at the time of the organization of said corporation, conducting business upon a scrip basis, and the securities belonging to the firm were in the hands of trustees to secure such scrip.

V.

" That said corporation was organized, among other things, for the purpose of taking over the business and affairs of said partnership and assuming the outstanding obligations.

VI.

" That the capital of said partnership was $200,000.00, which belonged to said Barnette, and the agreement existing between said partners was that the profits of said partnership were to be divided, one-half to said Barnette, and one-fourth each to said Hill and Wood.

VII.

" That thereafter, and in the fore part of January, 1908, a large number of business, professional and mining men of the Fairbanks Recording District, Alaska, met in the town of Fairbanks, Alaska, for the purpose of organizing a corporation to purchase and take over and absorb the business of the Fairbanks Banking Company, a partnership, and at said meeting negotiations were begun by said proposed incorporators with said copartnership for the purchase of the same. That at said meeting a committee was appointed to go into the details of the reorganization of the Fairbanks Banking Company, and to report a basis upon which the

business should be taken over, two of the members of this committee having been members of the committee of depositors which had in December examined the assets.

VIII.

" The said committee met on the 5th day of January, 1908, and, after investigating the affairs of the bank, made the following report to be presented for the consideration of the proposed new corporation:

" *(a)* That the issued stock for the proposed new corporation be as of date February 15, 1908; that notes be taken for all deferred payments; that the same bear interest at the rate of one per cent per month from February 15, 1908, until paid; that twenty-five per centum of the unpaid for stock be due and payable on or before June 1st, 1908, and that the balance be due and payable on or before July 1st, 1908.

" *(b)* That Captain E. T. Barnette and James W. Hill, with such associates as they may require, prepare a subscription list.

" *(c)* That the amounts subscribed by any person be left to that person, and in case of oversubscription should be reduced proportionately.

" *(d)* That the notes, properties and securities of the Fairbanks Banking Company, the old institution, examined by its present acting board of trustees and on which a valuation of $288,000.00 in excess of its liabilities was placed, be accepted.

" *(e)* That all notes, properties and securities which said board of trustees placed in the No. 3, or doubtful class remain the property of the old institution.

" *(f)* That all interest on existing loans as of December 19, 1907, be computed to February 15, 1908, and that the amount of such accrued interest be placed to the credit of the old institution on the books of the new corporation, and that the same be payable on or before December 31, 1908.

" *(g)* That should James W. Hill and R. C. Wood not take the full forty-four thousand dollars in stock in the new corporation, the balance of the amount not so taken to be paid to them not later than July 1st, 1908.

" *(h)* That the proposition of Captain E. T. Barnette to leave on deposit with the new corporation the sum of two hundred thousand dollars, without interest for one year, be accepted, and that it be the understanding that such deposit will secure said new corporation against any adverse decision of the Court in the *Caustens* v. *Barnette* suit in so far as such decision may decrease the value of the Gold Bar Lumber Company property as accepted by the present board of trustees.

" *(i)* That the officers of the new corporation be a president, vice-president, second vice-president, cashier, assistant cashier, treasurer, and secretary.

" *(j)* That the number of the Board of Directors be twelve, four to be elected for six months, four for twelve months, and four for eighteen months or until their respective successors are duly elected and qualified.

" *(k)* That dividends be declared semi-annually on June 30, and December 31.

IX.

" That said report was, on January 6th, 1908, submitted to said proposed incorporators, and at said meeting the said report was read, and passed on section by section as read, and on motion duly made and carried was adopted and ordered kept as a part of the records of said meeting.

X.

" That at said meeting a subscription list, a copy of which is set forth in paragraph 3 of the amended complaint in this cause, was presented and signed by said proposed incorporators, setting forth the amount for which each respectively subscribed.

XI.

" That at said meeting it was also agreed on behalf of the Fairbanks Banking Company, a copartnership, that said partnership would turn over to said corporation the property of said Fairbanks Banking Company, a partnership, on the terms specified in said report, and said proposed incorporators in behalf of said proposed corporation, in consideration thereof, agreed to assume the liabilities of said partnership.

XII.

" That said Fairbanks Banking Company, a corporation, became such on the 21st day of January, 1908. That on the 8th day of February, 1908, a meeting of the subscribers of the capital stock of the Fairbanks Banking Company was held for the purpose, among others, of obtaining notes of the subscribers for the stock subscribed by them, and, at said meeting, said stock notes were subscribed by said subscribers of stock and delivered to said corporation.

" That at the time of said meeting the Articles of Incorporation of said Fairbanks Banking Company had not been received from the State of Nevada, and for the purpose of expediency it was deemed advisable to elect a Board of Directors, and twelve directors were elected at said meeting, and it was agreed that said Board of Directors should act as such until the arrival of the Articles of Incorporation, when a formal meeting would be held and proper by-laws be adopted.

XIII.

" That said Articles of Incorporation did not arrive in Fairbanks until some time in the month of March, 1908, and immediately thereafter a meeting of the stockholders of the Fairbanks Banking Company, a corporation, was called, and at said meeting said stockholders, among other things, adopted by-laws and elected a Board of Directors; and also passed a resolution to the effect that the matter of taking over the property of the Fairbanks Banking Company, a partnership, be left to the Board of Directors.

" That on the 12th day of March, 1908, at said meeting of the subscribers to said capital stock, said subscriptions were accepted by them and the above-named Barnette, Hill and Wood, together with the other subscribers, were declared to be stockholders of the said corporation. The defendant Wood was not present at said meeting, but he was notified of the result of the same by the said Hill.

XIV.

" Subsequently, at a meeting of the stockholders of said corporation, it was resolved that

the matter of taking over the business and affairs of said partnership be left to the Board of Directors. Thereafter, on March 12, 1908, at a meeting of the Board of Directors, said matter was considered by them and the resolutions of the proposed stockholders, set out in Finding VIII hereof, were by said directors adopted and approved, except that the resolution providing for the payment of accrued interest up to February 15, 1908, was by them amended so as to read 'March 15, 1908.' At said meeting it was ordered by said Board of Directors that stock issue to said Barnette, Hill and Wood in exchange for the property received from them by said corporation, as follows: Barnette, 440 shares; Hill, 220 shares; Wood, 220 shares.

XV.

" That on the 16th day of March, 1908, a written agreement was entered into between said corporation and said partners, and on the same day the same was signed by the said Barnette and Hill, and also on behalf of said bank by its president and secretary, wherein the valuation of the resources of said partnership was fixed at $790,940.31 and its liabilities at $538,-940.31, leaving an excess of $252,000.00 belonging to the said Barnette, Hill and Wood, in which said agreement the said Barnette, Hill and Wood agreed to accept stock of the corporation at its par value for the amount of assets in excess of said liabilities, except $200,000.00 thereof should be placed to the credit of the said Barnette as a special deposit with said corporation upon the terms therein stated. By the terms of said agreement the amount of stock to be issued to Barnette, Hill and Wood was fixed at $52,-000.00 instead of $88,000.00 as contemplated by

said resolution and subscription, thus entitling Barnette to 260 shares and Wood and Hill each to 130 shares. A copy of said agreement is annexed to plaintiff's complaint and marked 'Exhibit One.'

XVI.

" That at the time said agreement was entered into, the said Barnette was president of the said corporation and also a member of the Board of Directors; the said Hill was a member of its executive committee and also its vice-president, and the said Wood was its cashier. That said Barnette, Hill and Wood were also members of the partnership with which the said corporation contracted respecting the matters set forth in said agreement, and were each personally interested therein adverse to said corporation.

XVII.

" That the matter of preparing the papers for the transfer of said property belonging to said partnership to said corporation was, by the Board of Directors, left to the executive committee, and the said executive committee examined the affairs of said partnership, and, under their direction, said written agreement was prepared and afterward submitted to the Board of Directors for approval, and by them approved.

XVIII.

" That according to the by-laws of said corporation, the said executive committee had the same powers as the Board of Directors, subject to the approval of their acts by said Board of Directors.

XIX.

" That at the time said written agreement was signed and executed, and during all of the negotiations leading up to the making of the same, the defendant Wood was in Seattle, Washington, but he was advised fully concerning the same by the said Hill by letter and by telegram.

XX.

" That prior to the return of said Wood to Fairbanks, to-wit, on the 29th day of February, 1908, he offered to sell his stock in said corporation and to take in payment therefor part cash and a note for the balance, to be secured by said stock as collateral security.

XXI.

" That the defendant Wood returned to Fairbanks, Alaska, some time in the month of April, 1908, and, upon his return, he signed said written agreement so entered into as aforesaid, knowing that the same contained said clause requiring him to take stock for his share of the assets of said partnership so transferred to said corporation in excess of the liabilities thereof as aforesaid, and also knowing that the same did not provide for the payment of said accrued interest, but with an oral understanding between himself and the officers of said bank that he might have, in accordance with said resolution, until July 1st, 1908, to elect either to take stock in said corporation or cash for his share of the assets of said partnership so transferred to said corporation.

XXII.

" That of the loans and discounts transferred by said partnership to said corporation, a large

amount were then past due, of which then past due paper the sum of $69,908.94 now remains in the hands of the receiver unpaid and uncollectible, which said loans and discounts were accepted by the directors of said corporation at their face value, and the same were included in those on which the accrued interest referred to in said resolution, was afterward computed.

XXIII.

" That of said notes so past due as aforesaid, there were two executed by the Tanana Electric Company in the sum of $27,997.38, which depended for their value upon the existence of an alleged guaranty of the Scandinavian-American Bank to make advancements sufficient to cover the same; that said alleged guaranty never had any existence in fact, and the claim therefor had been repudiated by said Scandinavian-American Bank prior to the time said note was accepted by said Board of Directors, and said repudiation was known to the members of said board. That said notes are still unpaid, and the same was at all times carried on the books of the said Washington - Alaska Bank, formerly Fairbanks Banking Company, as an asset in the sum of $27,997.38.

XXIV.

" That said Board of Directors and the officers of said bank accepted said notes of the Tanana Electric Company and paid therefor the sum of $27,997.38.

XXV.

" That among the other assets of said partnership so accepted by said officers and direct-

ors was four-fifths of the capital stock of the Gold Bar Lumber Company, a corporation existing in the State of Washington, which said stock was accepted and paid for at the valuation of $341,949.00, and said stock was at all times during the existence of said corporation carried as an asset in said sum.

XXVI.

" That at the first meeting of the Board of Directors, held on the 12th day of March, 1908, the defendant Wood was elected cashier of said bank, at which time he was then in the City of Seattle, Washington, as aforesaid. Immediate notice was given to him of said election.

XXVII.

" That said Wood accepted said office of cashier while in the said City of Seattle, and, on the 16th day of March, 1908, entered upon the discharge of his duties as such cashier, and, upon his return to said Fairbanks in April, 1908, as aforesaid, entered actively upon such duties and continued to so act until June 29, 1908, when he tendered his resignation as such cashier, and the same was accepted by the Board of Directors to be effective at the close of business on June 30, 1908, and one B. R. Dusenbury, who was then assistant cashier, was elected to succeed Wood as cashier.

XXVIII.

" That at the time said Wood tendered his resignation as cashier as aforesaid, he demanded that there be paid to him the amount of his interest in said partnership assets, to-wit, $13,000.00.

XXIX.

" That a certificate for 130 shares of the capital stock of said corporation had been written up in the name of the defendant Wood, of the par value of $13,000.00, but the same was never detached from the stock book. That said 130 shares were carried on the books of said bank as outstanding stock from March 16, 1908, to June 30, 1908.

XXX.

" That on the 30th day of June, 1908, with the knowledge. consent and approval of the officers and directors of said bank, a certificate of deposit was issued to and accepted by the said Wood in the sum of $13,000.00, in lieu of said stock, which said certificate was signed by the said B. R. Dusenbury as assistant cashier prior to the time when the said resignation of the said Wood as cashier became effective, and said shares of capital stock were on the same day charged to treasury stock on the books of said bank.

XXXI.

" That subsequently the said Wood drew out in cash from the funds of said bank the amount of the said certificate of deposit, to-wit, $13.-000.00.

XXXII.

" That of the notes accepted from said partnership, as aforesaid, and paid for by said corporation, there were charged on December 31, 1907, by said partnership on the books of said partnership to an account known as 'doubtful account' the sum of $22,979.99, and said doubtful account, so including said notes in said

amount, was then depreciated on the said books to the amount of thirty-three and one-third per cent thereof, which said notes were accepted by said corporation and paid for by them in the amount aforesaid, to-wit, $22.979.99, all of which said notes were then past due, and of which there still remains unpaid and uncollectible the sum of $12,860.61.

XXXIII.

" That on March 23, 1908, pursuant to said resolution of the said Board of Directors adopted on March 12, 1908, the accrued interest on said notes so transferred to said corporation was computed to March 15, 1908, in the sum of $39,642.81, and one-half thereof was placed to the credit of said Barnette, and one-fourth thereof each to the credit of said Hill and Wood on the books of said corporation, and subsequently the same was paid to the said Barnette, Hill and Wood in cash.

XXXIV.

" That of said interest so paid to said Barnette, Hill and Wood as aforesaid, approximately $7,500.00 thereof was never collected by said bank.

XXXV.

" That at the time the said Wood so surrendered his stock as aforesaid, on June 30, 1908, the total assets of said corporation, as shown by its books were $1,251,924.96 and its total liabilities were $1,290,843.43 including its outstanding capital stock in the sum of $201,600.00, including the $13,000.00 of stock of the defendant Wood. That among said assets the capital stock of the Gold Bar Lumber Company was car-

ried at a valuation of $341,949.00, and of its loans and discounts $75,699.61 were then past due and are still unpaid, of which amount $69,-908.94 were taken over from said partnership, included in which was the above - mentioned notes of the Tanana Electric Company in the sum of $27,997.38.

XXXVI.

" That at the time said partnership assets were transferred to said corporation as aforesaid, said Gold Bar Lumber Company was closed down and remained so until the fall of 1908; that immediately prior to its closing down, it had been operated at a loss; that no dividends have ever been paid on the capital stock of said Gold Bar Lumber Company during the time the same was owned by said bank.

XXXVII.

" That subdivisions 5 and 6 of Article XII of the by-laws of said corporation, adopted at the stockholders' meeting held March 12, 1908, provided that all issued and outstanding stock of the company that may be donated, to, or purchased by the company, or which shall revert by reason of failure to pay for the same, shall be treasury stock, and shall be held subject to the disposal of the action of the Board of Directors. Said stock shall neither vote nor participate in dividends while held by the company. The Board of Directors shall be given the first option to purchase for the corporation the stock of any stockholder, and shall be entitled to purchase the same provided said Board of Directors shall offer to pay to said stockholder the same amount as he might obtain from any other person.

XXXVIII.

" That the laws of the State of Nevada, under which said corporation was organized, provide that it shall not be lawful for the directors of a corporation organized thereunder to divide, withdraw or in any way pay to the stockholders any part of the capital stock of the company. Said laws further provide that a corporation may purchase its own stock in the manner provided therein, and that if the capital be decreased not in the manner provided by said laws the stockholders shall be liable for such sums as they may receive of the amount so reduced. None of the things required to be done in the matter of the purchase of stock by said corporation, or to reduce the capital thereof, were done in the surrender and purchase of the stock of the said Wood.

XXXIX.

" That on said June 30, 1908, the said Fairbanks Banking Company had no surplus nor undivided profits with which to purchase the stock of the said Wood and the same was paid for out of its capital.

XL.

" That the taking back of said stock and the payment therefor as aforesaid was i l l e g a l, wrongful, and in violation of the laws of the State of Nevada under which said corporation was organized.

XLI.

" That pursuant to the agreement heretofore referred to between the said Fairbanks Banking Company and the said partnership formerly existing between the said Barnette, Hill and Wood,

the said sum of $200,000.00 to be paid to the said Barnette was placed to his credit on the books of said corporation as a special deposit, and subsequently the entire sum thereof was paid to the said Barnette in cash and drawn out by him from the funds of said bank.

XLII.

" That the assets of the said bank now in the hands of the receiver are insufficient to pay its liabilities, and the amount of such liabilities is more than $470,000.00 in excess of the value of said assets.

" CONCLUSIONS OF LAW.

" Upon the foregoing Findings of Facts the Court finds as Conclusions of Law as follows:

" That the plaintiff take nothing against the defendant R. C. Wood on the cause of action stated in the complaint, and that said action be dismissed."

Upon the foregoing facts the court found that plaintiff was not entitled to recover and entered Decree dismissing plaintiff's action, which Decree is as follows:

" DECREE.

" *Be It Remembered* that on the 8th day of June, A. D. 1914, the above-entitled cause came on regularly for trial before the Court without a jury upon the issues as joined between the plaintiff and the defendant; the Honorable F. E. FULLER, Judge of said court, presiding; the

plaintiff appearing in person and by his attorney, O. L. Rider, and the defendant appearing in person and by his attorneys, John L. McGinn and A. R. Heilig.

" And thereupon the plaintiff and defendant in open court agreed to submit the issues herein for final determination upon the testimony adduced, the admissions of the parties contained in the pleadings herein, and upon the testimony, so far as the same is applicable to said issues, heretofore introduced and received by the Court in cause number 1756 entitled '*F. G. Noyes, Receiver of the Washington-Alaska Bank, a corporation, plaintiff*, v. *J. A. Jessen et al., defendants*,' pending in said court.

" And thereupon the Court, after hearing the arguments of respective counsel and upon consideration of said pleadings and of said testimony, and being fully advised in the premises, did, on the 6th day of July, 1914, make and file his findings of fact and conclusions of law upon the issues herein;

" And thereupon, upon consideration thereof, it is by the Court ordered, adjudged and decreed that the plaintiff take nothing against the defendant, R. C. Wood, by reason of his complaint herein, and that said action be and the same is hereby dismissed at the cost of the plaintiff.

" All of which is now finally ordered, adjudged and decreed, this 6th day of July, 1914.

" F. E. FULLER,

Judge of the District Court, Territory of Alaska, Fourth Division."

The case is here to review this action of the lower court, with the prayer that the decree be reversed and proper decree entered in this court granting to plaintiff the relief sought.

The following stand out boldly from the foregoing Findings of Fact:

1. Wood was a subscriber to the capital stock of the corporation.

2. He afterwards became a stockholder and officer of said corporation.

3. While such stockholder and officer he sold his stock to the corporation and received therefor $13,000.00.

4. At the time such sale was made, the liabilities of the corporation exceeded its assets as shown by its books $38,918.47, and said stock was paid for out of the capital of said corporation.

5. Said purchase was made in violation of the laws of Nevada, under which it was incorporated, and was illegal and wrongful.

6. Wood never paid for the stock, and the payment to him of $13,000.00 upon its surrender was without consideration, and fraudulent.

7. The oral understanding modifying the terms of the contract of March 16, 1908, is void.

SPECIFICATION *of* ERRORS.

The trial court erred in the following particulars:

I.

In making and entering the following Conclusion of Law (Rec., p. 87, Ex. 1):

> " That the plaintiff take nothing against the defendant, R. C. Wood, on the cause of action stated in the complaint, and that said action be dismissed."

II.

In making and entering a Decree herein that the plaintiff take nothing against the defendant, R. C. Wood, by reason of his complaint and that said action be dismissed at the cost of the plaintiff (Rec., p. 88, Ex. 2).

The questions presented by the foregoing Specification of Errors will be discussed under the following heads:

1. The secret oral understanding was void.

2. Is Wood liable to the Receiver for the amount received for the surrender of his stock?

(a) Could Fairbanks Banking Company purchase its own stock, especially out of its capital?

(b) If it could not, can the Receiver now recover the purchase money.

3. No consideration was received by the bank for this $13,000.00. It is a part of the assets of the bank which were fraudulently given away. The Receiver can now recover it as a trust fund.

ARGUMENT.

I.

The Secret Oral Understanding Was Void.

There are two instruments which may be considered as the subscription of the defendant, Wood. *First*, the subscription proper; and, *second*, the written agreement of March 16, 1908. By the subscription proper, Wood, through his partner, Barnette, signed the same paper that all other subscribers signed. This was an unqualified agreement to take the designated number of shares set opposite the subscriber's name. It was presented to the subscribers at a meeting held on March 12, 1908, by them accepted, and Wood by them declared to be a stockholder. His other partner, Hill, kept him fully advised by letter and telegraph of all proceedings concerning the re-organization (F. 19). He must, therefore, have been advised of this subscription and its acceptance. This subscription was made "prior to the 21st day of January, 1908." Wood must have regarded these proceedings as fixing his status as a stockholder, because a month later, on February 29, 1908, he offered to sell his stock taking part cash and the balance to be secured by the stock as collateral (F. 20). Subsequently a certificate for 130 shares of stock was written up in his name and the same was carried on the books of the corporation as outstanding stock during all the time Wood was cashier. This

all occurred approximately two months prior to the alleged oral understanding by which he now seeks to avoid the subscription. Having become a subscriber and then a stockholder in the foregoing manner, he was powerless to change the situation by a subsequent parol agreement with the officers of the bank. The parol agreement made two months later with such officers could not become a condition to the original accepted written subscription, without the consent of the other stockholders, at least.

> " When a corporation is organized, and a subscription to its stock previously made is accepted, such subscription becomes a contract binding according to its terms, the parties to which are the corporation on one side and the subscriber on the other."
>
> —*McNaught* v. *Fisher*, 96 Fed. 168, 37 C. C. A. 438.

> " The directors of a corporation have no power to cancel any part of a subscription to the capital stock without the consent of the other stockholders."
>
> —*Gathright* v. *Oil City Land & Improvement Co.*, (Ky.) 56 S. W. 163;
>
> *Chicago B. & M. Co.* v. *Lyon*, (Okla.) 69 Pac. 6.

Then, again, this subscription is restated when the written agreement of March 16, 1908, is entered into. It, by its express terms, bound Wood to take stock in the corporation for his share in the partner-

ship assets. Wood signed it on his return to Fairbanks in April, 1908, and, *when he signed it, he knew that it contained the clause requiring him to take said stock.* The "oral understanding" was not omitted through any fraud, accident or mistake. But he now says that clause in the contract must give way to the contemporaneous oral understanding had between himself and the officers of said bank, that he might have until July 1, 1908, to elect to take said stock or cash. Such option is void. It is a fraud upon the creditors, the other stockholders and upon the bank. The receipt of testimony to prove it violates a well known rule of evidence.

In Zane on Banks and Banking, Sec. 59, pages 94-95, it is said:

> " The engagement which a stockholder makes when subscribing for stock is to pay the amount of his stock subscription. This engagement is a contract with the corporation which becomes binding as soon as the corporation is formed. This capital fund must be paid to the corporation. * * * The contract may be avoided, it is true, on the ground of fraud if the subscriber is not estopped from making that defense. But conceding a valid subscription, the subscribed capital becomes the security of the creditors, and the stockholders are powerless to make any arrangement among themselves relieving them from this liability. Nor can the capital stock be divided up among the stockholders to the prejudice of the creditors of the corporation."

In *Topeka Mfg. Co.* v. *Hale*, (Kan.) 17 Pac. 601, it is said:

> " A parol agreement made at the time of subscribing for stock, and inconsistent with the written terms of a subscription, is immaterial, incompetent and void."

In Cook on Corporations (6th ed.) at section 81, it is said:

> " Under the general rule of evidence that a written agreement cannot be varied or added to by parol evidence, it is not competent for a subscriber to stock to allege that he is but a conditional subscriber. *The condition must be inserted in the writing in order to be effectual.*"

Again at section 137, the same author says:

> " Where a subscription contract is absolute on its face, it is well settled, both in equity and at law, that parol evidence of previous or contemporaneous negotiations, stipulations, terms, or agreements is not admissible to vary or add to the contract, except for the purpose of proving that the parties, at the time of consummating the agreement, intended and understood that such terms and stipulations would be incorporated in the contract, but omitted the same by accident, fraud or mistake. This rule, forbidding the introduction of parol evidence to explain, contradict or vary a written instrument, applies to a subscription contract for stock in a corporation. *Neither party is permitted to prove a different contract from that expressed in the written instrument. Under the rule, not*

even a separate written contemporaneous contract is admissible to change the subsbcription contract."

Again at section 170, he says:

" A cancellation of a subscription, to the detriment of corporate creditors, may be impeached by the latter and set aside. Especially is this the rule when the cancellation is made after the corporation has become insolvent."

Again at section 191, he says:

" In fact, *secret agreements to release are void*, and subscribers receiving them are liable on their subscriptions absolutely, as though no special advantages had been promised."

In *Putnam* v. *N. A. & S. C. J. R. R. Co.*, (U. S.) 21 L. ed. 361, 363 (reported in 16 Wall. 390 under title *Burke* v. *Smith)*, the Supreme Court of the United States says:

" And it is clear that the directors of a company, organized under the law, have no power to destroy it, to give away its funds, or deprive it of any means which it possesses to accomplish the purposes for which it was incorporated. The stock subscribed is the capital of the company, its means for performing its duty to the commonwealth, and those who deal with it. Accordingly, it has been settled by very numerous decisions that *the directors of a company are incompetent to release an original subscriber to its capital stock, or to make any arrangement with him by which the company, its creditors, or the*

state shall lose any of the benefit of his subscription. Every such an arrangement is regarded in equity, not merely as ultra vires, but as a fraud upon the other stockholders, upon the public and upon the creditors of the company. * * *

" * * * Conditions attached to subscriptions, which, if valid, lessen the capital of the company, thus depriving the state of the security that the railroad would be built, and diminishing the means intended for the protection of creditors, are, therefore, a fraud upon the grantor of the franchise and upon those who may become creditors of the corporation. *They are also a fraud upon unconditional stockholders,* who subscribed to the stock in the faith that capital sufficient would be obtained to complete the projected work, and who may be compelled to pay their subscriptions, though the enterprise has failed, and their whole investment has been lost. *It is for these reasons that such conditions are denied any effect.*"

In *Morgan* v. *Struthers*, 131 U. S. 246, 33 L. ed. 132, 135, Mr. Justice LAMAR, speaking for the court, referred to the principle herein contended for as

"a doctrine settled in a great number and variety of decisions, that a corporation has no legal capacity to release an original subscriber to its capital stock from the payment of it, in whole or in part; and that any arrangement with him by which the company, its creditors, or stockholders, shall lose any part of that subscription, is *ultra vires* and a fraud upon creditors and the co-subscribers (citing cases). This doctrine rests upon the principle that the stock subscribed, both paid and unpaid, is the capital of

the company, and its means of carrying out the object for which it was chartered and organized."

In *Sawyer* v. *Hoag*, 17 Wall. 610, 21 L. ed. 731, the principle is declared that no agreement, device or artifice between the corporation and its stockholders, the effect of which is to deprive the creditors of the benefit of this trust fund or any portion of it, is valid against creditors.

The Fairbanks Banking Company, afterwards known as Washington-Alaska Bank, for which plaintiff sues herein as Receiver, was organized under the laws of the State of Nevada. If by the laws of the State of Nevada, such oral agreements are void, then Wood is bound by such law.

—*Giesen* v. *London etc. Mtg. Co.*, 102 Fed. 584, 42 C. C. A. 515.

Relfe v. *Rundle*, 103 U. S. 222, 226, 26 L. ed. 337;

Silver Mines v. *Brown*, 58 Fed. 644, 7 C. C. A. 412;

Railway Co. v. *Gebhard*, 109 U. S. 527.

In *Giesen* v. *London etc. Mtg. Co.*, *supra*, the court said:

" When a person subscribes for stock in either a domestic or a foreign corporation, *he thereby consents to be governed by the provisions of its charter or the general law under which it is incorporated,* and by such by-laws as the corporation may lawfully enact, *and that his rights and liabilities as a stockholder shall be tested and determined by such laws.*"

In construing the provisions of the constitution and statutes of another state, the decisions of the Supreme Court of that state are controlling.

—*Fairfield* v. *County of Gallatin*, 100 U. S. 50;
Fowler v. *Lamson*, (Ill.) 34 N. E. 932, 933.

In the case of *Thompson* v. *Reno Savings Bank*, 7 Pac. 68, the Nevada court held:

> " The decisions uniformly hold that any secret arrangement between the corporation and its stockholders by which the responsibility of the latter is made less than it appears to be under the articles of incorporation is v o i d as against creditors."

In the case last cited, the capital stock was represented to be $100,000.00, but there was a secret agreement that only thirty per cent need be paid in. Suit was brought for the remaining seventy per cent due on the stock and this agreement was interposed as a defense, and the principle above quoted was declared to be the law of Nevada. It ought not to be necessary to cite any further authority on this proposition in view of the rule in *Geisen* v. *Mtg. Co.*, *supra*, and *Fairfield* v. *County of Gallatin*, *supra*.

But the principle has also been announced in the Supreme Court of the United States. In *Upton* v. *Tribilcock*, 91 U. S. 45, 23 L. ed. 203, it is held:

> " A contract between a company or its agents and the stockholders, limiting their liability as

to unpaid installments of stock is void as to creditors of the company, and as to the rights of the assignee who represents the creditors."

Again in *Sanger* v. *Upton*, 91 U. S. 56, 23 L. ed. 220, the same court held:

" A resolution or agreement by the directors that no further call shall be made, is void as to creditors. The capital stock of an incorporated company is a fund set apart for the payment of its debts, and it cannot be diverted from such purpose."

In *Thompson* v. *Reno Savings Bank, supra*, the Nevada court defined the term "capital stock" to be "the amount of money paid or promised to be paid for the purposes of the corporation."

In *Scoville et al.* v. *Thayer*, 105 U. S. 143, 26 L. ed. 969, certificates of stock by agreement between the corporation and its stockholders, were issued as fully paid when in fact there had only been twenty per cent thereof actually paid. Plaintiffs as Assignees in Bankruptcy under order of court made an assessment and call upon the unpaid stock for the purpose of paying the debts of the corporation, and upon failure to pay the same, an action at law was brought against defendant. The court said (26 L. ed. 973):

" The stock held by the defendant in error was evidenced by certificates of full paid shares. It is conceded to have been the contract between

him and the company that he should never be called upon to pay any further assessments upon it. The same contract was made with all the other shareholders, and the fact was known to all. As between them and the company this was a perfectly valid agreement. * * * But the doctrine of this court is, that such a contract, though binding on the company, is a fraud in law on its creditors, which they could set aside; that when their rights intervene, and to satisfy their claims, the stockholders could be required to pay their stock in full. *Sawyer* v. *Hoag*, 17 Wall. 610; *New Albany* v. *Burke*, 11 Wall. 96; *Burke* v. *Smith*, 16 Wall, 390.

" The reason is, that the stock subscribed is considered in equity as a trust fund for the payment of creditors. (Citing cases.) It is so held out to the public, who have no means of knowing the private contracts made between the corporation and its stockholders. The creditor has, therefore, the right to presume that the stock subscribed has been or will be paid up, and if it is not, a Court of Equity will at his instance, require it to be paid."

In *Olmstead* v. *Vance & Jones Co.*, 63 N. E. 634, the Illinois Supreme Court, said:

" This court has repeatedly held that, as against the claims of creditors, it is immaterial what private arrangements subscribers may make with the corporation, and that any device by which the members of the corporation seek to avoid the liability imposed upon them by law is void as to creditors, whether binding or not as between themselves and the corporation. (Citing cases.) If such an arrangement as that made

between the Smith & Jones Company and Bentley & Olmstead could be enforced, a corporation might then, at the time of its organization, make such a contract with each of its stockholders as to totally destroy the capital stock of the concern, and deprive the creditors of all security from this trust fund. The capital stock is a trust fund furnished for the benefit of the creditors of the corporation, and equity will not permit it to be destroyed or impaired to their injury for the benefit of stockholders. The creditors of this corporation had a right to rely upon the application of the capital stock toward the payment of their claims; and to permit this plaintiff in error to cancel his stock upon this inequitable agreement, and to receive a premium of ten per cent, in addition, would be a violent disregard of a long line of decisions of this court."

If exception be taken to the Illinois decisions because of the trust fund theory alluded to in the above quotation, reference is again made to the Nevada case of *Thompson* v. *Reno Savings Bank*, *supra*, wherein it is held that "*The capital stock*, and especially the unpaid subscriptions thereto, *is a trust fund* for the benefit of the general creditors." Thus putting Nevada in line with those jurisdictions declaring the capital stock of a corporation to be a trust fund, and by that rule the incorporators of the Fairbanks Banking Company are bound.

In *Barto* v. *Nix*, (Wash.) 46 Pac. 1033, it is held (3 syl.):

" In an action by a receiver of an insolvent bank against the directors to recover the par

value of stock held by them, which had not been paid for, the defendants can not set up in defense a secret agreement with the bank that they should not pay for the stock, nor incur any liability by reason of its issuance to them, but should hold it for the benefit of the corporation."

I do not think it necessary to comment at length upon the decisions outside of the Nevada and Federal Courts upon this matter. They should be conclusive as to this point, and under them the oral understanding sought to be availed of is absolutely void, and Wood must be regarded as a stockholder and not as an optionee. If further authorities are desired, reference is respectfully made to the cases cited in the note to the sections of Cook on Corporations above quoted.

The Nevada decision above referred to was rendered in construction of the identical incorporation law under which the Fairbanks Banking Company was incorporated, and p r i o r to its incorporation. Hence, in construing the provisions of the statutes of that state, the decisions of its Supreme Court are controlling.

—*Fairfield* v. *County of Gallatin*, 100 U. S. 50;
Fowler v. *Lamson*, (Ill.) 34 N. E. 932.

For another reason, the oral understanding is void. It was had between the defendant and the "officers of said bank." The officers of the bank were powerless to make such an agreement binding upon

the bank. The bank in such matters could only be bound by its Directors, acting together as a board, and the only action they ever took was to approve the written contract which obligates Wood to take the stock. (F. 17.)

Trustees of a corporation can only bind it when they are together as a board, acting as such.

—*Hillyer* v. *Overman, S. M. Co.*, 6 Nev. 51.

II.

Is Wood liable to the Receiver for the amount received for the surrender of his stock?

(a) **Could Fairbanks Banking Company purchase its own stock, especially out of its capital?**

(b) **If it could not, can the Receiver now recover the purchase money?**

The right of a corporation to purchase its own stock has been frequently before the courts, and they are divided on the question. Generally, however, where the right has been allowed, it was derived from statute: or, where not derived from statute, the offending corporation was acting within some exception to the rule prohibiting it, as where, for example, it was not prejudicial to the rights of creditors, or stockholders: or where the purchase was not made out of the capital, but out of surplus or undivided profits: or where it was necessary in order to be relieved of a stockholder whose association was injuri-

ous to the company; or to prevent the loss of a debt due the company. None of these grounds appear in the case at bar. The reason for denying to a corporation the right to re-purchase its own stock is generally grounded upon the principle, either that the capital is a trust fund upon which creditors have a prior claim over stockholders, or that creditors have a right to rely upon some added liability which attaches to one owning stock over and above the amount invested in such stock. In either event it is considered contrary to sound public policy to permit the stockholders to divide among themselves the fund to which creditors look for payment of their claims. Again, it is prejudicial to the other stockholders. It is highly inequitable to allow one stockholder without the consent of the others, to withdraw his share of the common venture in full, leaving the others to risk what they ventured in a joint enterprise. If the offending corporation has such right and exercised it to the full limit, all of its capital could be distributed to its stockholders, or certain favored ones, leaving to creditors and other stockholders, only its promises to pay. Of course the right to re-issue the stock would be existant, but what would that avail when its assets had been depleted or consumed? Stock which merely evidenced a liability to assessment would not avail creditors much in satisfying their claims.

In the case at bar none of the above noted exceptions to the rule exist, and we are dealing solely with the right of an insolvent corporation to repurchase its own stock. On June 30, 1908, when the transac-

tion complained of was had, the Fairbanks Banking Company had liabilities exceeding its assets in the amount of $38,918.47, as shown by its books (F. 35). Included in those assets were the worthless notes of the Tanana Electric Company, aggregating $27,-997.38 (F. 23). Here was a corporation unquestionably insolvent to the extent of $66,915.85, nearly one-third of its outstanding capital, without any consideration of its other past due and uncollectible paper or the Gold Bar Lumber Company stock. While in this condition, Wood withdrew $13,000.00 of its capital in cash, by which act his interest as a stockholder was protected, but the rights of its creditors rendered further precarious. To put beyond controversy the matter that this corporation was insolvent and that the purchase was made out of its capital, reference is further made to Finding 39, which is as follows:

> " That on said June 30, 1908, the said Fairbanks Banking Company had no surplus nor undivided profits with which to purchase the stock of the said Wood and the same was paid for out of its capital."

In his work on Corporations, section 311 (6th ed.), Mr. Cook, after alluding to the difference of opinion in the American courts as to the right of a corporation to repurchase its stock says (p. 849):

> " The objection usually made to allowing a corporation to purchase its o w n stock is that thereby the corporate funds are expended and no property is received by the corporation, ex-

cept the right to resell. This objection is merely a limit to the power of the corporation to purchase. In Illinois, the state where the right of the corporation to make such purchases is most clearly and decisively established, the collateral principle that such purchases are to be declared illegal and voidable at the instance of corporate creditors who are injured thereby is distinctly stated and rigidly applied. *If the corporation is insolvent at the time of the purchase, it is clearly an invalid transaction, and will be set aside. The rule goes still further, and declares that if a corporation, by a purchase of shares of its own capital stock, thereby reduces its actual assets below its capital stock and debts, or if the actual assets at that time are less than the capital stock and debts, such purchase may be set aside, and the guilty corporate officers, as well as the vendor of the stock, may be rendered liable thereon at the instance of a corporate creditor.*"

In Thompson on Corporations, section 1548, it is said:

" For a corporation to repurchase its shares at a price which the subscriber has paid for them is simply to distribute the trust fund of creditors, hereafter spoken of, among t h o s e from whom it was originally collected. *That this can not be done as against creditors, if it has any, is plain. That it can not be done as against shareholders is equally plain.* In the absence of special circumstances, such as rendering allowable compromises, it is safe to say that this can not be done as against other shareholders, in the absence of statutory authorization, without unan-

imous consent. For this reason, *the general rule is that a corporation can not purchase and hold its own shares.*"

Again at section 2054, the same author says:

" The capital stock of a corporation being a trust fund for creditors, *the general rule, in the absence of an enabling statute, is, that a corporation cannot employ its funds in purchasing its own shares,* thus distributing its capital among its shareholders to the manifest detriment of its creditors. As was observed by Lord HERSCHEL, L. C.: 'Stringent precautions to prevent the reduction of the capital of a limited company without due notice and judicial sanction, would be idle if the company might purchase its own shares wholesale.' and if it were otherwise, the result would be that the shareholders would receive back the money subscribed, and there would thus pass into their pockets what before existed in the form of cash in the coffers of the company, or of buildings, machinery, or stocks available to meet the demands of the creditors. And he also held that the purchase of shares for the purpose of reselling would be a trafficing or dealing in shares and unlawful. The rule which forbids a corporation thus to employ its funds rises to the grade of a rule of public policy; and is so strong that, although power is conferred upon the company to deal in the shares of joint-stock companies generally, this does not authorize it to deal in its own shares. It is immaterial whether the transfer is made to the company itself, or to a nominee of the directors to hold in trust for the company: in the latter case, equally with the former, it is invalid."

In Morawetz on the Law of Private Corporations, section 112, it is said:

> " A purchase by a corporation of shares of its own stock in effect amounts to a withdrawal of the shareholder whose shares are purchased from membership and a repayment of his proportionate share of the company's assets. There is no substitution of membership under these circumstances as in case of a purchase and transfer of shares of a third person, but the members of the company and the amount of its capital are actually diminished. Whatever a transaction of this character may be called in legal phraseology, it is clear that it really involves an alteration of the company's constitution, just as the withdrawal of a member of a co-partnership with his proportionate share of the joint funds involves an alteration of the constitution of a co-partnership. The amount of the company's assets and the number of its shareholders are diminished. Every continuing shareholder is injured by the reduction of the fund contributed for the common venture; and the creditors who have trusted the company upon the security of the capital originally subscribed, or who are entitled to expect that amount of security, are entitled to complain.
>
> " It is no answer to say that shares having a market value must be regarded like any other personal property, and that no person is injured if a solvent corporation in good faith purchases shares in itself at their market value, inasmuch as the shares so purchased are property in the hands of the company and may at any time be reissued or sold. *No verbiage can disguise the fact that a purchase by a corporation of shares*

of itself really amounts to a reduction of the company's assets and that the shares purchased in fact remain extinguished, at least until the reissue has taken place. The fact that such a transaction may not necessarily be injurious to any person is not a sufficient reason for supporting it. It is contrary to the fundamental principle of the stockholders and is condemned by the plainest dictates of sound policy. To allow the directors to exercise such a power would be a fruitful source of unfairness, mismanagement and corruption. It is for these reasons that a shareholder can not be allowed to withdraw from the corporation with his proportionate amount of capital either by a release and cancellation before the shares have been paid up or by a purchase of the shares with the company's funds."

The court found (F. 38) the provisions of the Nevada law, under which Fairbanks Banking Company was organized, respecting the repurchase by a corporation of its own stock to be as follows:

" *That the laws of the State of Nevada, under which said corporation was organized, provide that it shall not be lawful for the directors of a corporation organized thereunder to d i v i d e , withdraw or in any way pay to the stockholders any part of the capital stock of the company. Said laws further provide that a corporation may purchase its own stock in the manner provided therein, and t h a t if the capital be decreased not in the manner provided by said laws the stockholders shall be liable for such sums as they may receive of the amount so reduced. None of the things required to be done in the matter of the purchase of stock by said corporation, or to*

reduce the capital thereof, were done in the surrender and purchase of the s t o c k of the said Wood."

From the foregoing, it is clear that the corporation is forbidden to divide, withdraw or in any way pay to the stockholders *any part of the capital stock.* The stockholders must keep their hands off of it. The court found (F. 39) that the Wood stock was paid for out of the capital of the bank. Such corporations are by said law, however, permitted to purchase their own stock or reduce the amount thereof, by pursuing the course provided by the laws of that state, none of which things were done in the surrender and purchase of the Wood stock, and the court accordingly finds (F. 40) that the taking back of said stock and payment therefor was "illegal and wrongful and in violation of the laws of the State of Nevada." The penalty provided in the law for such a transaction is "that the stockholders shall be liable for such sums as they may receive of the amount so reduced" (F. 38).

As in the matter of the effect of the oral understanding, by which the written agreement of March 16, 1908, was attempted to be conditioned, the Nevada court has also spoken upon the violation of the statutes of that state, which is a l l u d e d to in the court's finding, *supra.* I again refer to *Thompson* v. *Reno Savings Bank,* 7 Pac. 68.

In the case last cited, the articles of incorporation fixed the capital of the bank at $100,000.00, but it was agreed between the stockholders that only thir-

ty per cent of the stock need be paid in. One Lake was a stockholder and upon the failure of the bank, suit was brought against him by the receiver for the remaining seventy per cent due on his stock. He interposed this agreement as a defense. The court, after holding that the capital stock of a corporation organized under the laws of the state for the purpose of banking is the amount paid or promised to be paid for the purposes of the incorporation, and it is a "fixed sum, not to be increased or diminished, except in the mode permitted by the statute," characterizes such an arrangement as one "made in defiance of the statute under which it was incorporated," and then quotes section 3543 of the Compiled Laws, as follows:

> " It shall not be lawful for the directors to divide, withdraw or in any way pay to the stockholders or any of them, any part of the capital stock, nor to reduce the amount of the same."

In the *Thompson* case, there was a surrender to the stockholder of a part of the capital stock "promised to be paid," which was condemned, and for which recovery by the Receivers was had. In the case at bar, the Receiver is following and seeking to recover that part of the actual active capital—the very corpus of the bank—which was divided, withdrawn and paid over to a stockholder. In the *Thompson* case, "the mode permitted by the statute" was not followed, and penalty of the statute was visited upon Lake. Neither was it followed in Wood's case

(F. 38), and he likewise should be compelled to repay the amount which he received, as the statute provides. In the opinion in the *Thompson* case, the Nevada court sets out the statutory provisions for any change in the amount of the capital, and then says:

> " The publicity required in this proceeding is for this purpose—in part at least—of advising the public dealing with the corporation of the proposed change. The requirement of the statute—*first*, that the publicly recorded certificate of incorporation shall state the amount of the capital; and, *second*, that any change in the amount thereof shall only be made after extended public notice—is in direct conflict with the secret contrivance alleged to have been made by Lake and his associates."

Under the rule in *Fairfield* v. *County of Gallatin*, *supra*, and in *Giesen* v. *London etc. Mtg. Co.*, *supra*, the decision of the Nevada court in the *Thompson* case is binding upon this defendant and ought to settle every phase of this litigation in favor of the Receiver herein.

The fact that the by-laws of the Fairbanks Banking Company may have contemplated the purchase of its stock by the bank (F. 37) is no defense to the acts complained of. Being in conflict with the law of Nevada, such provision is void.

—*State ex rel Corey* v. *Curtis*, 9 Nev. 325;
Herring v. *Ruskin Co-op. Ass'n*, (Tenn.) 52 S. W. 327;
Vercoutre v. *Golden State Land Co.*, (Cal.) 48 Pac. 375.

The National Bank Act forbids a national bank to purchase any of its shares unless the purchase shall be necessary to prevent loss upon a debt previously contracted. Violations of this act have on several occasions brought the statute before the federal courts for construction, but most generally in cases where a stockholder subsequently purchasing the stock from the bank resisted an assessment upon the ground that the stock was void. In such cases, the court, while declaring the sale of the stock to the bank to be illegal, declined to hold the stock to be void. The distinction is readily apparent between the illegal act of the bank in purchasing and the validity of the stock itself. The stock being valid, such subsequent transferee takes good title to it; but in such case no title passed to the bank.

In the case of *Burrows* v. *Niblack*, 28 C. C. A. 130, 132-3, Burrows sold his stock in Chemical National Bank to said bank in violation of the National Bank Act. The receiver sued to recover the amount paid him for the same. The lower court found that the sale was "illegal, null and void, and the plaintiff, consequently, entitled to recover of the defendant the sum paid, with interest," and this judgment was affirmed by the Circuit Court of Appeals for the Seventh Circuit. In the opinion, the court said:

> " The transaction here in question is not a purchase made for the purpose of preventing, or which was necessary to prevent, loss upon a debt previously contracted, but, as set forth, it was a

bald purchase by the bank of its own stock for cash, and necessarily involved for the time being a reduction *pro tanto* of the corporate stock. *Even if it were not forbidden by the statute, the transaction would be inconsistent with public policy and with established principles of law. * * * The purchase was outside of and beyond the powers of the bank, and, therefore, as a corporate act, was void from the beginning;* and, while it appears from the agreement that the certificates of stock were endorsed in blank and delivered to the president of the bank, the latter did not thereby acquire, nor the plaintiff in error part with, title to the stock. The money having been unlawfully paid out, the bank had an immediate right of action to recover it in an action of assumpsit. It was not necessary to go into equity, nor to offer a return of the stock."

In *Johnson* v. *Laflin*, 13 Fed. Cases 764, Laflin, a stockholder in a National Bank, sold his stock to one Britten, president of the bank. The sale was made through a broker who gave his personal check to Laflin for the purchase price. It subsequently developed that Britten had paid the broker for the stock with the money of the bank, but without the knowledge of Laflin. A bill in equity was filed to have Laflin declared to be still a stockholder of the bank; to have Britten ordered to re-transfer the shares to Laflin on the books of the bank; and for a money judgment against Laflin for the amount he received. The court held that inasmuch as Laflin was ignorant of the fact that the money paid him was the money of the bank no recovery could be had. The opinion

was rendered by Judge DILLON, one of the ablest corporation lawyers who ever sat on a United States bench, and in the course of the opinion, he added the following *dictum:*

> " Inasmuch as this act, 'The National Bank Act,' in express terms prohibits a national bank from thus becoming the purchaser of the shares of its own capital stock, if Laflin had made a contract to sell his shares to the bank, or to its president for the bank, it is plain that such a contract would have been *ultra vires* and illegal, both as respects creditors and other stockholders, and the transaction could have been impeached by the bank in its corporate capacity, or by its other shareholders, even if it were still solvent and going on, or by the receiver as the officer appointed to wind up its affairs. *In re London, etc., Exchange Bank*, 5 Ch. App. 444-452; *Great Eastern Railway Co.* v. *Turner*, 8 Ch. App. 149; *Currier* v. *Lebanon Slate Co.*, 56 N. H. 262. And although Laflin did not contract to sell his shares direct to the bank, or to the president for the bank, still *if before the transaction was completed he had notice, actual or constructive, that the purchase was, in fact, a purchase for the bank, and paid for by the money of the bank, the transaction can not stand, and the receiver may compel him to pay back the money thus received* and have him declared still to be a stockholder.
>
> " It would be easy to support this proposition by argument and by the authority of adjudged cases, but they are so plain that it is not necessary to do so."

There can be no question but that Wood knew the purchase was for the bank and paid for by the money of the bank. There is no attempt to claim that it was otherwise. Indeed, the transaction is justified under the so-called oral understanding. The purchase was clearly illegal—in defiance of the laws of Nevada. How, then, can it stand? Why may not the Receiver compel him to pay back the money thus received?

The case last cited was appealed to the Supreme Court (*Johnson* v. *Laflin*, 103 U. S. 800, 26 L. ed. 532) and was affirmed in an opinion by Justice FIELD, who added thereto this observation:

> " Of course, the whole case here would be changed if the sale by Laflin had not been made in good faith, but was made merely to evade his just responsibility as a stockholder, or to work a fraud upon other stockholders or creditors of the bank."

In *Upton* v. *Tribilcock*, 91 U. S. 45, 23 L. ed. 203, the Receiver of an insurance company was permitted to recover of stockholders unpaid installments of stock, which had been released under an agreement between the company and its stockholders. The court said:

> " The capital stock of a moneyed corporation is a fund for the payment of its debts. It is a trust fund, of which the directors are the trustees. It is a trust to be managed for the benefit of its shareholders during its life, and for the

benefit of its creditors in the event of its dissolution. This duty is a sacred one, and cannot be disregarded. Its violation will not be undertaken by any just-minded man, and will not be permitted by the courts. The idea that the capital of a corporation is a football to be thrown into the market for the purposes of speculation, that its value may be elevated or depressed to advance the interests of its managers, is a modern and wicked invention. *Equally unsound is the opinion, that the obligation of a subscriber to pay his subscription may be released or surrendered to him by the trustees of the company. This has been often attempted, but never successfully. The capital paid in, and promised to be paid in, is a fund which the trustees cannot squander or give away. They are bound to call in what is unpaid and carefully to husband it when received.*"

In the case last cited, the Receiver was following and recovering "capital promised to be paid in"; but the decision says that capital paid in as well as that promised to be paid in can not be squandered or given away by the directors.

In *Sanger* v. *Upton*, 91 U. S. 56, 23 L. ed. 220, the court said:

" The capital stock of an incorporated company is a fund set apart for the payment of its debts. It is a substitute for the personal liability which subsists in private co-partnerships.

" When debts are incurred, a contract arises with the creditors that it shall not be withdrawn or applied, otherwise than upon their demands, until such demands are satisfied. The creditors

have a lien upon it in equity. If diverted, they may follow it as far as it can be traced, and subject it to the payment of their claims, except as against holders who have taken it *bona fide* for a valuable consideration and without notice. It is publicly pledged to those who deal with the corporation, for their security. Unpaid stock is as much a part of this pledge, and as much a part of the assets of the company, as the cash which has been paid in upon it. Creditors have the same right to look to it as to anything else, and the same right to insist upon its payment as upon the payment of any other debt due to the company. As regards creditors, there is no distinction between such a demand and any other assets which may form a part of the property and effects of the corporation."

In *Bundy* v. *Jackson*, 24 Fed. 628, the Hot Springs National Bank owned $500.00 of its own stock which was carried on its books as $550.00 cash. The president and cashier signed the name of a fictitious person to a promissory note, payable to their order for $550.00, which they endorsed to the bank and took up this stock and had the same transferred to themselves on the books of the bank. About the time the bank closed its doors, they transferred the stock back to the bank and destroyed the note. The Receiver brought suit on the note. Judge CALDWELL, in rendering judgment for the amount of the note and interest, said:

" The subsequent effort of Bruon and the defendant to relieve themselves from liability, by transferring the stock back to the bank and tear-

ing up their note, was futile. The statute declares the bank shall not purchase its own stock, unless such purchase shall be necessary to prevent loss upon a debt previously contracted. The purchase by the bank, through its president, of the stock owned by himself and the defendant was not made to prevent such a loss. The president of the bank had no power to purchase stock from strangers, or release the claims of the bank against any person. Morse, Bank, 146, 147. And, of course, he could not act in the double capacity of buyer and seller, and contract with himself for the discharge of his own obligation, and, as president of the bank, purchase stock from himself, which the bank by law was prohibited from purchasing from any one. *For this act there could be no authorization in advance, and no ratification afterwards. It does not have to be formally disaffirmed by the directors or the receiver, because neither could ratify or impart validity to it if they desired to do so. The sale of the stock by the bank was enjoined upon it by law, and its sale by the president could therefore be ratified, however irregular it may have been in the first instance; but the purchase of the stock by the bank was interdicted by law, and was therefore incapable of ratification. The assets of the bank constitute a trust fund for the benefit of its creditors, and when wrongfully diverted can be followed in whosoever hands they can be traced.* The debt incurred by the defendant to the bank, by the purchase of the stock and the execution of the note, has never been paid. The destruction of the evidence of the debt did not pay the debt. *The title to the stock never passed from Bruon and the defendant to the bank. The stock is theirs, and if in the possession of the bank, or the receiver, it is held in*

trust for them. If the acts practiced by the president and cashier of the bank in this case can be indulged in with impunity by bank officers, then the safeguards provided by statute for the security of depositors and other creditors of the bank are blank paper."

In *Wood* v. *Dumner*, 30 Fed. Cases 435, No. 17944, an incorporated bank, before the expiration of its charter, divided three-fourths of its capital stock among the stockholders without providing funds sufficient to p a y its outstanding notes. Mr. Justice STORY, delivering the opinion, held that the capital stock was a trust fund for the payment of the bank's debts and might be followed into the hands of the stockholders. This case is cited with approval in *Scoville* v. *Thayer*, 105 U. S. 143, 26 L. ed. 968, 973.

In *Hamor* v. *Taylor, Rice Eng. Co.*, 84 Fed. 187, one Willard sold his stock to the corporation and received therefor its promissory note. After appointment of receiver, he presented his claim for allowance based upon said note. It was held (Syl. 4 and 5):

" In the absence of statutory authority in that behalf, a corporation, whether solvent or insolvent, has no legal power to reduce the fund represented by its capital stock by any formal or voluntary act on its part, to the prejudice of its creditors *then or thereafter existing*, by distributing any part of it among the stockholders by way of dividend, or by giving any part of it to one or more stockholders, or by disposing of

any part of it in any manner, except by way of changing its form to meet the exigencies of the corporate business.

> " *It is ultra vires of a corporation to dispose of any part of its property, other than surplus or net profits, for the purchase of shares of its own stock, and a promissory note given by the corporation for that purpose is a nullity.*"

In *Farrington* v. *Tennessee*, 95 U. S. 679, 686, the court said:

> " The capital stock is the money paid or authorized or required to be paid in as the basis of the business of the bank, and the means of conducting its operations. It represents whatever it may be invested in. If a large surplus be accumulated and laid by, that does not become a part of it. The amount authorized can not be increased without proper legal authority. If there be losses which impair it, there can be no formal reduction without the like sanction. *No power to increase or diminish it belongs inherently to the corporation. It is a trust fund, held by the corporation as a trustee.*"

In re Brocking Mfg. Co., 35 Atl. 1012, the Supreme Judicial Court of Maine, held:

> " Stockholders of a corporation have no rights until all other creditors are satisfied. They have the full benefit of the profits made by the establishment, but can not take any portion of the funds until all other claims on them are extinguished. Their r i g h t s are not to the capital stock, but to the residuum after all demands on it are paid.

" Where the funds of a corporation are used by its treasurer to pay for its stock purchased by him and other stockholders for themselves with the consent of all the stockholders and directors, he thereby became responsible for the whole amount of money so converted.

" So long as he holds the money in the treasury of the corporation, it is there to answer for its debts, if necessary; and it should be devoted to that object so long as it may be required for that purpose, if he withdraws it, except according to law, he does so subject to that trust—the trust for the payment of the debts of the corporation, and needed for that purpose; and it is immaterial whether he got the money by fair agreement with his associates or by a wrongful act."

A statute authorizing the reduction of capital stock and providing a method for doing so excludes the right to resort to any other or different method and does not authorize a bank to diminish its capital by purchasing its own stock, quoting Marowitz on Law of Private Corporations, section 112, *supra.*

—*Maryland Trust Co.* v. *Nat. Mech. Bank,* (Md.) 63 Atl. 70.

In *Tait* v. *Pigott,* (Wash.) 73 Pac. 364, and 80 Pac. 172, a stockholder sold his stock to the corporation. Thereafter, the corporation became insolvent and the Receiver sued to recover the amount paid for the stock. Recovery was allowed, and it was held that such a purchase by the bank was a reduction of its capital stock which could only be done in the manner

provided by the code, and that it violated the provisions of section 4265, making it "unlawful to * * * in any way to pay to the stockholders or any of them, a n y part of the capital stock." The Washington statute, unlike that of Nevada, did not expressly provide that a stockholder shall be liable for such sums as he may receive of the capital when reduced in violation of the method prescribed by statute. Nevertheless, recovery was permitted under the provision of section 4265 above quoted, which is otherwise identical with the Nevada statute (F. 38).

In *Fitzpatrick* v. *McGregor*, (Ga.) 65 S. W. 859, in a case where a stockholder surrendered his stock as a credit upon his note held by the corporation, it was held that the stockholder held the money or credit so received by him subject to the superior equities of the creditors of the corporation and that a receiver subsequently appointed could recover of the stockholder the amount of such credit.

In *Adams & Westlake Company* v. *Deyette*, 5 S. D. 418, 425, and 8 S. D. 127, an action was brought to set aside certain judgments rendered in favor of Deyette and Lewis against the Hicks-Trask Hdw. Co. by confession, for money loaned by them to said corporation with which to purchase certain of its shares of stock owned by Track and which was to their knowledge for such purpose. The court held (5 S. D. 425):

> " Independently of the question of a c t u a l fraud in the case under consideration, the immediate effect of the purchase of the Trask stock

at a time when the corporation was financially embarrassed, if not, indeed, insolvent, was to increase its liability, without adding anything to its resources to which plaintiff could look for the security or payment of its claim; and such conduct is contrary to the spirit, if not the letter, of our statute, and is not upheld by the courts."

In *Currier* v. *Slate Co.*, 56 N. H. 262, it was held:

" The funds of an insolvent corporation can not be taken to buy a portion of its capital stock. * * * It would be grossly inequitable and a fraud upon other creditors."

In *German Savings Bank* v. *Wulfekuhler*, 19 Kan. 60, an action was brought by the bank against Wulfekuhler to recover $2100.00 alleged to have been wrongfully obtained through a stock surrender. Defendant was vice-president and a director of the bank, and, although the stock was purchased and held in his name, it really belonged to a partnership of which he was a member. The bank became embarrassed and defendant, operating through a third party, named Herman, as a dummy, sold the stock to the bank and received therefor $2100.00, and it was considered by Herman and the cashier of the bank, who made the purchase, that the transaction was a sale to the bank. The court said:

" The supposed sale of said stock from Herman to the bank was void. The cashier had no

authority from the bank, or from any one else, to purchase it; and no one had any power to give him any such authority. A bank can not purchase its own stock, except in some few cases for the purpose of securing some previously-existing debt. There is no law that attempts to give a bank any such power. And the purchasing by a bank of its own stock is not one of the objects for which banks are created, and is not legitimate banking business. For a bank to use its funds in the purchase of stock, is to withdraw that much of its capital from legitimate banking business; and to purchase its own stock, is in effect a withdrawal of that much of its stock from actual existence, and in that way the bank might reduce the amount of its capital stock below the amount required by law and might also impair or even destroy all security given by law to the creditors of the bank. The law provides in effect that not only the bank, with all its property, shall be liable for its debts, but also that each stockholder in the bank to the amount of his stock, shall also be held liable. But if the bank may purchase in all its stock, and own it itself, then where would be the security to the creditors of the bank, except in the bank itself? They could not, after exhausting the property of the bank, find any stockholders to sue. The law never contemplated any such thing."

In *Hall* v. *Henderson*, 126 Ala. 449, 28 So. 531, an officer of a corporation sold his stock nominally to a third person, but in reality to the corporation itself. In permitting the Receiver of the corporation to recover therefor, the court rested its decision "upon the doctrine that it is a voluntary conveyance or transfer

as against creditors by the corporation of its assets," and said:

> " The fact of the insolvency of the Alabama Terminal & Improvement Company is sufficiently proven by the evidence. But this fact is immaterial under the view we take of this case for if it be true that Henderson received the assets of the corporation knowingly, or under such circumstances as to put him upon inquiry that the money paid to him for his stock was the money of the corporation in consideration of a sale by him of the stock to the corporation direct, or through Woolfolk and Saportas to the corporation, *or if the consideration inuring to the corporation was his stock, then it is, in effect, a gift by the corporation to him of its assets, which is fraudulent as to creditors, whether the corporation was actually insolvent at the time the bargain for the sale of the stock was made or not.* There can be little doubt, if that were important, that it was on the road to financial disaster when the alleged sale was made, and was hopelessly insolvent long before Henderson received any of the payments made to him."

The principle of the Alabama case that "if the consideration inuring to the corporation was his stock, then it is, in effect, a gift by the corporation to him of its assets," and therefore fraudulent, when applied to the facts attending the surrender of the Wood stock, renders the fraud upon the Fairbanks Banking Company and its creditors and other stockholders doubly aggravated. It received nothing from Wood for the stock it issued to him, as hereinafter

pointed out, but, upon the surrender of the same by him, he received $13,000.00 in cash from the capital contributed by the other stockholders. The Alabama court again condemns such transactions in *Hall* v. *Alabama T. & I. Co.*, 143 Ala. 464, 39 So. 285, in the following language:

> " The purchase by a corporation of shares of its own capital stock is a fraud upon its creditors. Such shares neither import nor represent any right or claim in or to, or to subject to their payment, the assets of the corporation as against the rights of creditors. Shares purchased by the corporation have no value as assets, for the payment of corporate debts. Obviously, therefore, the transaction involves on the one hand, the diversion of corporate assets to persons—shareholders — who have no debt against the company, nor the shadow of claim to or against its assets so far as creditors are concerned, and, on the other, the acquisition by the company in the stead of assets thus diverted, of a mere right to re-issue certain shares, or shares to a certain amount, in its capital; which right is of no value as assets for creditors. *Such a diversion of corporate property is, in respect of creditors, essentially a gift to the shareholders whose shares are purchased by the company—a purely voluntary transfer of corporate assets in fraud of corporate creditors, fraudulent and void as to creditors, and this, regardless of the intention actuating the company and the selling shareholders.*"

In *Crandall* v. *Lincoln*, 52 Conn. 73, the Receiver of an insolvent corporation recovered on behalf of its creditors the money paid out to its stockholders in

the purchase of shares held by them, although the stockholders supposed they were r e a l l y selling to third persons and not to the corporation. The theory of the Connecticut court was that the capital stock of such a corporation is to be treated in equity as a trust fund in cases where the rights of creditors have been impaired by its misappropriation. Hence a stockholder, who receives a part of the capital in return for his stock, holds the money so received as trustee for the creditors and a Receiver may follow and recover it. In the Connecticut case, insolvency was not actually declared and receivers appointed until three years after the stock surrenders were made, which in point of time is very similar to the case at bar.

In *Commercial National Bank* v. *Burch*, 141 Ill. 519, 31 N. E. 420, one West transferred his stock in the J. L. Regan Printing Company, a corporation, to said corporation, and received in return therefor its note secured by an assignment of its book accounts. This note and said assignment, West transferred to the Commercial National Bank before maturity of the note. Subsequently, in an action praying for the dissolution of the Printing Company, Burch was appointed Receiver, and said bank filed its intervening petition seeking to establish a preference over other creditors, and have said book accounts, when collected, applied in discharge of said note. The court dismissed the intervening petition, which, on appeal, the appellate court affirmed. This action was affirmed by the Supreme Court in the following language,

holding that these book accounts, as part of a trust fund, might be followed and recovered even in the hands of an innocent assignee:

> " The transfer of the notes from West to the bank, having been made before the note was due, made the bank an innocent holder of the note for value, and protected it under the rule which protects the innocent purchaser of negotiable paper; but the book accounts were mere choses in action, and the assignment of them a transfer of so much of the property of the J. L. Regan Printing Company to West to satisfy said note. Each successive assignee of a chose in action takes it subject to the equities existing between the original assignor and his immediate assignee. Therefore, if West could not hold the book accounts as collateral security for the payment of the $13,000.00 note, the bank could not hold them: for as far as the assignment of the book accounts was concerned, the bank stands in the shoes of West. It holds its negotiable promissory note relieved from all defenses, but held the book accounts subject to all defenses; therefore, subject to the claims of the creditors of the corporation."

The court, in the case last cited, just preceding the foregoing quotation, said:

> " The question is settled by the decision of the case of *Clapp* v. *Peterson*, 104 Ill. 26, where it was held that the purchase of its own stock by a corporation by the exchange of its property of equal value, though made in good faith and without any element of fraud about it—there not being anything in the apparent condition of the

company to interfere with making of the exchange—will not be allowed where it injuriously affects a creditor of the company, even though the fact of the indebtedness was not at the time established or known to the stockholders. The court holds that the capital stock of an incorporated company is a fund set apart for the payment of its debts, and that the directors of the company hold it in trust for that purpose, and say 'the shareholders of the corporation are conclusively charged with notice of the trust character which attaches to its capital stock.' As to it, *they cannot occupy the status of innocent purchasers, but they are to all intents and purposes, privies to the trust. When, therefore, they have in their hands any of its trust fund, they hold it cum onere, subject to all equities which attach to it.*"

In *Bank* v. *Ross*, 68 Conn. 29, defendant, a stockholder in a corporation, sold his stock to the company and received in return a note and mortgage executed directly to him by one Turner, whose mortgage indebtedness to the company in an equal amount was thereby discharged. The trustee in insolvency was permitted to recover of the defendant the value of said asset. It was held (first Syl.):

> " It is now well settled that in equity the capital stock of a corporation constitutes a trust fund for the payment of debts; and courts will be astute to detect and defeat any scheme or device which is calculated to withdraw this fund, or in any way place it beyond the reach of creditors."

If a corporation be incompetent to release a subscriber to its capital stock whose subscription has not been paid, it is equally without authority, to expend the fund represented by its capital stock for the purchase of shares held by a stockholder who has paid for them.

—*Hamor* v. *Taylor-Rice Eng. Co.*, 84 Fed. 392, 397.

At the time the agreement was entered into by which the business of the partnership was transferred to the bank, Wood, though a member of said partnership, was also cashier of said bank, and was "personally interested adverse to said corporation" (F. 16). It was incumbent upon him to exercise the very highest of good faith in his dealings with it. Secret agreements by which personal adverse interests are advanced do not measure up to the standard of such good faith. Under such circumstances, it would be a flagrant fraud to give vitality to it. To countenance such secret arrangements and double dealing would be unconscionable. For this fraud, if for no other reason, equity will impress a trust upon the funds so received for the benefit of any person injured thereby.

In 3rd Pomeroy's Eq. Jur., (3rd ed), Sec. 1047, it is said:

> " By the well settled doctrines of equity, a constructive trust arises whenever one party has obtained money which does not equitably belong to him and which he cannot in good conscience retain or withhold from another who is ben-

> eficially entitled to it; as, for example, when money has been paid by accident, mistake of fact, or fraud, or has been acquired through a breach of trust, or violation of fiduciary duty, and the like."

It is no answer to the contentions herein presented to say that the Receiver is seeking to rescind an executed contract between the partnership and the corporation, as was urged at the trial below. That agreement spent its force when the partnership property was transferred to the corporation and its shares of stock accepted by Wood and his partners. The taking back of this stock by the bank and the payment therefor out of its funds was a new and distinct, though wholly illegal, transaction—not between the partnership and the bank, but between Wood and the bank. The only pretense of a link between the two transactions is the so-called "oral understanding" which is void. It is as a thing which never had any existence. The funds received by Wood in exchange for his stock came into his hands impressed with a trust, and it is not only the right, but the duty of the Receiver to follow and recover them.

The stock came to Wood by virtue of said executed agreement. The Receiver is not seeking to rescind that agreement. It is the transactions thereafter had of which he complains. The right of a Receiver to recover from a stockholder funds of a corporation received by him in purchase of his stock is fully sustained by the authorities heretofore reviewed.

From the foregoing review of authority, the following principles are deducible:

1. Subscriptions to the capital stock of a corporation cannot be conditioned by collateral agreements.

2. A corporation cannot, out of its capital, purchase its own stock in the absence of statutory authority.

3. Where the statute provides a method for reducing the stock of a corporation, no other can be resorted to.

4. The capital stock of a corporation, whether paid in or promised to be paid in, is a trust fund to secure the c l a i m s of creditors and cannot be squandered or given away.

5. If a stockholder exchange his stock for any part of the capital of a corporation, he receives the same impressed with a trust in favor of creditors.

6. Such corporation or its receiver may follow and recover the funds so received, and in some instances may retake them even in the hands of an innocent transferree.

7. The basic principle upon which is grounded the right of the receiver of a corporation to recover against a stockholder for cancellation of his sub-

scription, or sale of his stock to the corporation, is public policy. The capital, whether paid in or to be paid in, must be kept intact for the benefit of its creditors. To accomplish this, the receiver may vacate such cancellation, levy and collect assessments for u n p a i d installments of subscription, and follow and recover as a trust fund any part of the capital which has been divided among the stockholders. To deny him these rights is to countenance a fraud.

8. The purchase of Wood's stock was, according to the laws of Nevada, an unlawful reduction of stock, and, by the same laws, a stockholder is liable for such sums as he may receive of the amount so reduced (F. 38).

III.

No consideration was received by the bank for this $13,000. It is a part of the assets of the bank which were fraudulently given away. The Receiver can now recover it as a trust fund.

It will be remembered that said transfer of partnership business was made upon the basis of $52,000.00 of assets in excess of its liabilities, one-fourth of which, or $13,000.00 was the share of this defendant. This pretended excess was the consideration for the stock to be issued to Wood and his partner. But the court found (F. 23) that among said part-

nership assets were two worthless notes executed by the Tanana Electric Company, aggregating $27,-997.38. The court also found (F. 22) that of said assets there were loans and discounts past due when transferred and which still remain in the hands of the Receiver unpaid and uncollectible amounting to $69,909.74, included in which is said Tanana Electric Company notes. As a further asset, there was transferred four-fifths of the capital stock of the Gold Bar Lumber Company for which the corporation paid $341,949.00 (F. 25). Respecting this stock, the court found (F. 36) that at the time of said transfer said Gold Bar Lumber Company was closed down and remained so until the fall of 1908; that immediately prior to closing down, it had been operated at a loss; and that no dividend had ever been paid on said stock during the time it was owned by said bank. Included in the assets of said partnership was also an item of loans and discounts aggregating $22,979.99 which on December 31, 1907, had been by said partnership charged to an account known as "doubtful account," and then depreciated 33 1/3%. These notes last referred to were also accepted and paid for by the corporation at their *face value* of $22,979.99. They were all past due at the time of the transfer to the corporation, and of them there still remains in the hands of the Receiver unpaid and uncollectible the sum of $12,860.61 (F. 22).

On March 23, 1908, pursuant to a resolution of the Board of Directors, adopted March 12, 1908, there was placed to the credit of said partners on the

books of the corporation the sum of $39,642.81 as accrued interest to March 15, 1908, on the notes transferred from the partnership, one-fourth of which was subsequently paid to Wood in cash (F. 33), approximately $10,000. The contract of March 16, 1908, providing for the transfer of the assets of the partnership to the corporation makes no provision for turning this accrued interest over to the partners. By its terms (see agreement, Rec., p. 29, referred to in F. 15) the partners "assign, transfer and set over unto the party of the second part all their outstanding loans and discounts as the same appear in the scheduled statement hereto attached marked Exhibit 'A', and the notes of the debtors given to evidence the amount of such loans and discounts," which notes are listed in said schedule at fixed amounts. When Wood, in April, 1908, signed this written agreement he did so "knowing that the same did not provide for the payment of said accrued interest" (F. 21). He, therefore, was not entitled to this interest under the contract.

It, therefore, appears from the Findings of the Court that by taking up the worthless Tanana Electric Company notes of $27,997.38 and the payment of $39,642.81 as accrued interest, $67,640.19 were allowed the partners for which no assets were transferred to the corporation and which completely wipes out the pretended excess of $52,000.00 over liabilities, which was the consideration for stock. This is true without any reference to other worthless and uncollectible notes which were transferred, or to the

depreciated "doubtful accounts" for which full value was paid, or to the capital stock of the Gold Bar Lumber Company, which certainly, under the circumstances, ought to have been depreciated some instead of increasing it $68,318.69, as was done by increasing the value of its timber lands one-third (see agreement at Rec., p. 42, referred to in F. 15).

By means of this pretended excess of assets over liabilities, one-fourth of which or $13,000.00 belonged to Wood, he paid for the stock in question. A certificate for the same, of the par value of $13,000.00, was written up in his name, and, although never detached from the stock book, it was carried on the books of the bank as outstanding stock from March 16, 1908, to June 30, 1908 (F. 29), during all of which time Wood was the cashier of the bank (F. 27). On June 29, 1908, Wood tendered his resignation as cashier and the same was accepted to be effective at the close of business on June 30, 1908 (F. 27). On June 30, 1908, and prior to the time said resignation became effective, a certificate of deposit in the sum of $13,000.00 signed by Dusenbury as assistant cashier, was issued to and accepted by Wood in lieu of said stock, and said shares of stock were on the same day charged to treasury stock on the books of said bank. (F. 30.) Later on, the certificate of deposit was converted into cash and the proceeds thereof withdrawn from the bank (F. 31).

On these facts the complaint charges that the withdrawal of said $13,000.00 from the assets of the

bank was without consideration and was wrongfully and fraudulently done in violation of the terms of said written agreement and the rights of the creditors of said corporation. (Complaint, Par. 13, Rec., pp. 9-10.)

Wood must have known, or by the exercise of the slightest care could have known, that the stock which he was surrendering had not been paid for because of the facts above stated. As heretofore pointed out, the Receiver is not seeking to rescind the executed agreement between the partnership and the corporation. By that agreement, Wood acquired the stock. The taking back of this stock by the bank and payment therefor out of its funds was a new and distinct, though illegal, transaction—not between the partnership and the bank, but between Wood and the bank. Let it be assumed that the transaction by which Wood acquired his stock could not be rescinded, and clearly such rescission is not the purpose of this action, nevertheless the fact remains that the bank received nothing for said stock. It had no property of the defendant which stood back of the stock and which the bank retained when the stock was surrendered. The bank, although in existence but two months and a half, during all of which time Wood was its cashier, had impaired its capital, as shown by its books to the extent of $38,918.47 (F. 35), without regard to the depreciation of its assets hereinbefore commented on. The stock therefore represented no right to share in surplus or undivided profits, because the bank had none (F. 39). What then

did the bank get for its $13,000.00 in cash? Nothing, although its capital suffered a further impairment to that extent.

Suppose an insolvent bank should wish to borrow $13,000 and should execute its note in that sum payable to its cashier from whom it expected to borrow the money, and the cashier should turn over to the bank as the proceeds of the note $13,000 in bogus money. The transaction is entered upon the books of the bank as a genuine transaction. Later on, the cashier demanded his money and the assistant cashier turned over to him $13,000 in good money, cancelled the note, and entered that transaction upon the books of the bank. Would any court permit the cashier to retain those funds against the creditors of the bank or even the bank itself? If implied assumpsit did not afford the necessary remedy, a resort to equity could be had and a constructive trust decreed (3rd Pomeroy's Eq. Jur., Sec. 1047).

In the case at bar, the money of the bank was obtained under the guise of a stock transaction. Wood agreed to buy stock of the bank at the par value of $13,000.00 to be paid for in property. The bank accepts Wood as a stockholder and writes up the stock certificate, which is not detached from the stock book although carried on the books of the bank as outstanding stock. Wood is cashier of the bank and Dusenbury its assistant cashier. Wood fails to deliver the property, but does deliver an instrument pretending to do so. Later on, upon his demand, the

stock certificate is cancelled, said shares charged to treasury stock, and the assistant cashier issues to Wood the bank's certificate of deposit for the par value of the stock, $13,000.00, which is subsequently cashed. When the transaction occurred, the liabilities of the bank exceeded its assets approximately $39,000 as shown by the books of the bank. The money which Wood received was known by him to be a part of the assets of the bank, and for it he gave nothing. It came into his hands impressed with a trust in favor of the bank's creditors, and that trust has never been discharged. It is respectfully submitted that in good conscience he should not be permitted to keep it.

In *Upton* v. *Tribilcock*, 91 U. S. 45, 23 L. ed. 203, it is said:

> " The capital paid in, and promised to be paid in, is a fund which the trustees cannot squander or give away."

In *Sangor* v. *Upton*, 91 U. S. 56, 23 L. ed. 220, it is said:

> " The capital stock of an incorporated company is a fund set apart for the payment of its debts. * * * The creditors have a lien upon it in equity. If diverted, they may follow it as far as it can be traced, and subject it to the payment of their claims, except as against holders who have taken it *bona fide* for a valuable consideration and without notice. It is publicly pledged to those who deal with the corporation, for their security."

In *Thompson* v. *Reno Savings Bank*, 7 Pac. 68, being the Nevada case heretofore referred to at length, the capital stock of a corporation is declared to be "a trust fund for the benefit of the general creditors." Wood, having given no consideration therefor and acting with full knowledge of all the circumstances, took this $13,000.00 impressed with such trust, and subject to the right of the Receiver to follow and recover it for the benefit of the general creditors.

In the case of *Commercial National Bank* v. *Burch*, (Ill.) 31 N. E. 420, heretofore considered, the court, speaking of shareholders who receive the property of a corporation in exchange for their shares of stock, and after stating that the directors of an incorporated company hold the capital stock in trust, said:

> " As to it, they cannot occupy the *status* of innocent purchasers, but they are, to all intents and purposes, privies to the trust. When, therefore, they have in their hands any of this fund, they hold it *cum onere* subject to all equities which attach to it."

The foregoing principle is re-affirmed in *Olmstead* v. *Vance & Jones Co.*, (Ill.) 63 N. E. 634, 636, and the court added:

> " And this is so irrespective as to whether there were fair dealings or actual or constructive fraud between the parties."

In *Hall* v. *Henderson*, 126 Ala. 449, 28 So. 531, the court said:

> " The fact of the insolvency of the Alabama Terminal and Improvement Company is sufficiently proven by the evidence. But this fact is immaterial under the view we take of this case for if it be true that Henderson received the assets of the corporation knowingly * * * or if the consideration inuring to the corporation was his stock, then it is, in effect, a gift by the corporation to him of its assets, which is fraudulent as to creditors, whether the corporation was actually insolvent at the time the bargain for the sale of the stock was made or not."

In *Putnam* v. *N. A. & S. C. J. R. R. Co.*, (U. S.) 21 L. ed. 361, 363 (reported in 16 Wall. 390 under title *Burke* v. *Smith)* it is said:

> " And it is clear that the directors of a company, organized under the law, have no power to destroy it, *or to give away its funds*, or deprive it of any means which it possesses to accomplish the purposes for which it was incorporated."

Interest.

Plaintiff is entitled to interest at the legal rate of 8% from June 30, 1908.

> " When money has been misappropriated or converted to his own use by defendant, interest is given as damages to compensate the complainant for the loss of the use of his funds. In cases of the latter class, its allowance is sometimes a matter of discretion; but it is a general rule, both at law and in equity, that, whenever one has wrongfully detained or misappropriated the moneys of another, he must pay interest at the legal rate from the date of the misappropriation or from the beginning of the detention."
>
> —*Cooper* v. *Hill*, 94 Fed. 582, 36 C. C. A. 402, 409;
>
> *Burrows* v. *Niblack*, 28 C. C. A. 130;
>
> *Bundy* v. *Jackson*, 24 Fed. 130.

It is respectfully submitted that upon the facts found, the Decree of the lower court ought to be vacated and a Decree entered in this court in favor of appellant and against appellee for $13,000.00 with interest and costs.

Respectfully submitted,

O. L. RIDER,
Attorney for Appellant.